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No. 91-1677

In The

Supreme Court of the United States

October Term, 1992

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF THE RESPONDENT

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QUESTION PRESENTED

Whether Congress intended, when it enacted ERISA, to impose penalty taxes on any employer who contributes property other than cash to a defined benefit pension plan.

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BRIEF OF THE RESPONDENT

STATEMENT

Respondent[1] generally agrees with Petitioner's Statement of the Case. Respondent adds, however, that the properties contributed by Respondent to the Keystone Consolidated Master Pension Trust (the "Trust") were later sold by the Trust to unrelated third parties for net amounts (i.e., after selling expenses) greater in the aggregate than the fair market value of the properties on the dates of contribution. Petitioner has never suggested that Respondent overvalued the properties that it contributed,

[1] Respondent has no parent corporation and no subsidiaries other than wholly owned subsidiaries.

nor has Petitioner previously argued that the facts of this case represent in any way an abusive transaction.

SUMMARY OF ARGUMENT

Section 4975(c)(1)(A) of the Internal Revenue Code of 1986 (the "Code") describes the "sale or exchange, or leasing, of any property" between an employer and a pension plan as a "prohibited transaction." In direct contravention of Petitioner's own administrative interpretation and the ordinary meaning of the phrase "sale or exchange," Petitioner now argues that this statutory language, enacted as part of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. 1001 *et. seq.*, creates "a categorical rule" barring employers from contributing property to pension plans. Pet. Br. at 12. Relying on her "categorical" rule, Petitioner now seeks to impose approximately $13 million in penalties against Respondent. The Tax Court and the United States Court of Appeals for the Fifth Circuit both rejected the Petitioner's position and held that a "contribution" of property by an employer to a defined benefit pension plan is not a "sale or exchange" within the meaning of Code § 4975(c)(1)(A).

The two-tier excise taxes imposed by Code § 4975 are penalty taxes. Under this Court's precedents, Code § 4975 must be strictly construed and its penalties can apply only when the words of the statute plainly impose them. The words do not impose them here. If Congress had intended to prohibit contributions of property to pension plans, it would have done so expressly. Congress did not

do so. Indeed, in language that is dispositive of this case, Code § 4975(f)(3) states that a transfer of property by an employer to a plan "shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes. . . . " Congress enacted this provision so that an employer could not borrow money by using property as collateral and then force the plan to repay the indebtedness by contributing the property subject to the mortgage. Under Petitioner's view that there is a "categorical rule barring employers from contributing property to pension plans," Code § 4975(f)(3) makes no sense.

Petitioner argues that Code § 4975(f)(3) was designed to expand Code § 4975(c)(1)(A) so that purely "voluntary" contributions of mortgaged property to a pension plan would be treated as a "sale or exchange." The words "voluntary" or "involuntary," however, appear nowhere in the statute, and there is no indication in the statute or legislative history that Congress was aware of, or gave any thought to, such a distinction. Moreover, the income tax case law that Petitioner relies on as her sole support for her definition of a "sale or exchange" has never distinguished between a "voluntary" and an "involuntary" contribution. *All* contributions to pension plans have been treated as "sales or exchanges" for federal income tax purposes since long before Congress enacted ERISA.

Petitioner now concedes that an employer's "voluntary" contribution of property to a pension plan is a "sale or exchange" for income tax purposes. She argues nevertheless that it is a "sale or exchange" between the employer and the employees and thus is not a prohibited

transaction. Under fifty years of income tax law, however, any transfer of property subject to a mortgage is a "sale or exchange" *between the transferor and the transferee* because the transferee must either pay the indebtedness or relinquish the property. Petitioner thus asks this Court to apply the income tax definition of a "sale or exchange" when interpreting Code § 4975(c)(1)(A), but to ignore that definition when interpreting Code § 4975(f)(3). Petitioner is forced to this inconsistent position in an attempt to reconcile her argument with the plain meaning of Code § 4975(f)(3).

Petitioner's argument that a contribution of property should be a prohibited transaction is patently inconsistent with the statutory structure established in ERISA to govern contributions to defined benefit pension plans. Code § 404(a) provides a tax deduction for both cash and noncash contributions to defined benefit plans. It is inconceivable that Congress would grant a deduction for a "prohibited transaction." Code § 412(b) provides that defined benefit pension plans must establish and maintain a "funding standard account," which account is increased by the "amount considered contributed" by the employer. Code § 412 is the statutory source for an employer's funding obligation that, according to Petitioner, converts a transfer of property into a prohibited "sale or exchange." There is nothing, however, in Code § 412 that suggests that an employer must contribute cash in order to fund its pension plan or to increase its funding standard account.

To enforce Code § 412, Code § 4971 imposes a two-tier excise tax on any employer who maintains a pension plan with an "accumulated funding deficiency." Code

§ 4971 is the penalty imposed on an employer that fails to make contributions to a plan. If an employer contributes noncash property to a plan and overvalues that property, Petitioner is permitted under Code § 4971 to assert excise taxes against the employer for failing to meet its funding requirements. Code § 4971 does *not* require employers to make cash contributions.

Petitioner and the amicus argue that this Court should reject the opinions of the Tax Court and the Fifth Circuit and instead defer to the administrative interpretations of the Department of Labor (the "DOL") (as expressed in an unpublished advisory opinion) and the Internal Revenue Service (the "IRS") (as expressed in revenue rulings interpreting a different statute than the one at issue here). Petitioner's argument for deference is more than merely wrong – it is an outrageous abuse of process. Until 1989, six years after Respondent made the contributions at issue in this case, Petitioner's own administrative position, as articulated in the Internal Revenue Manual, was that it was *not* a prohibited "sale or exchange" for an employer to contribute noncash property to a defined benefit plan unless the plan documents themselves imposed an obligation on the employer to contribute cash to the plan. In 1989 Petitioner amended her administrative position, stating only that a contribution of property to a defined benefit plan "*may*" be a prohibited "sale or exchange" depending on the application of Code § 4975(f)(3), i.e., if the property is subject to a mortgage.

The Internal Revenue Manual is the only place (other than in this case) where the IRS has expressed an administrative interpretation of Code § 4975. Respondent

respectfully submits that it is an outrage for Petitioner now to assert $13 million in penalties against one particular taxpayer when Petitioner for years advised the revenue agents who audit employers that a contribution of unencumbered property was *not* a prohibited "sale or exchange."

ARGUMENT

I. THE STATUTORY LANGUAGE OF CODE § 4975 AND STATUTORY STRUCTURE GOVERNING PENSION PLAN FUNDING PERMIT AN EMPLOYER TO CONTRIBUTE NONCASH PROPERTY TO A PENSION PLAN

A. The Statutory Scheme That Governs Plan Funding And Imposes Funding Obligations Demonstrates That Congress Understood And Expected That Employers Would Fund Defined Benefit Plans With Noncash Property

Petitioner argues that a contribution of property from an employer to a pension plan in satisfaction of a statutory funding requirement is a prohibited "sale or exchange." Her sole authority for this position is that a transfer of property in satisfaction of an indebtedness is treated as a "sale or exchange" under the income tax laws for purposes of recognizing gain or loss. In making her argument, however, Petitioner completely ignores the statutory structure of ERISA. It is essential to understand this structure to understand why a "contribution" of property within the meaning of ERISA is not a prohibited "sale or exchange."

Employers establish defined benefit pension plans to pay retirement benefits to employees based on employment service. An employer that maintains a defined benefit plan promises a fixed benefit to its employees upon retirement. Prior to the enactment of ERISA, employees on occasion suffered substantial hardship when an employer failed to meet its promises to provide a fixed retirement benefit. Congress enacted ERISA to ensure that workers received those benefits. One of the principal purposes of ERISA was to establish a tax structure under which employers would have to make annual contributions to pension trusts sufficient to ensure that funds would later be available to pay benefits. The various elements of that tax structure demonstrate that Congress intended to permit noncash contributions of property.

1. Code § 412, the statute that imposes funding obligations, does not require cash contributions

Under a defined benefit plan, an employer promises to pay retirement benefits to employees based on each employee's service. In contrast to a defined contribution plan, the employer promises "benefits" rather than "contributions." In order to ensure that funds are available to pay promised benefits, however, Congress enacted Code § 412. Under Code § 412(b), employers must establish and maintain a "funding standard account" so that pension trusts will have adequate resources to pay benefits. Code § 412(a) provides that an employer shall have satisfied its "minimum funding standard" if the funding standard account does not have "an accumulated funding deficiency." Code § 412(b)(3)(A) then states that the funding

standard account shall be credited with "the amount *considered* contributed by the employer to or under the plan for the plan year" (emphasis added).

Code § 412 is a long and comprehensive statute that covers every aspect of an employer's obligation to fund a defined benefit pension plan. The statute even includes provisions authorizing the Treasury Department to waive an employer's funding obligation in the event of financial hardship. Code § 412(d). If Congress had intended to prohibit employers from meeting their minimum funding standard with noncash contributions, Code § 412 would be the only sensible place to impose that requirement. Nothing in Code § 412, however, even hints that an employer must fund its plan with cash only.

Because Code § 412 does not impose an obligation to contribute cash, the fundamental premise of Petitioner's case is in error. Petitioner states repeatedly that the transfer of property in satisfaction of a "monetary" or "dollar" obligation is effectively a sale of the property for cash. Pet. Br. at 8, 14. Since Code § 412 does not require cash contributions, however, an employer does not have a "monetary" obligation. Petitioner's argument is therefore circular. She believes that a cash contribution is required because a noncash contribution is a "sale or exchange." She believes that a noncash contribution is a "sale or exchange" because the contribution satisfies a cash obligation. Since no requirement to satisfy a funding obligation with cash exists, however, her argument is specious.

2. Code § 4971 provides the penalty for noncompliance with Code § 412. Nothing therein requires cash contributions

Code § 4971 is the enforcement mechanism for Code § 412. Code § 4971(a) imposes a 10% first-tier excise tax on any employer that maintains a plan with an accumulated funding deficiency (5% tax in the case of a multiemployer plan). If the accumulated funding deficiency is not later corrected, Code § 4971(b) imposes a 100% second-tier excise tax on the amount of the deficiency. The excise taxes imposed by Code § 4971 thus mirror the two-tier excise taxes under Code § 4975 that Petitioner has asserted in this case. Under Code § 4971, if an employer contributes property to a plan and the employer claims a credit for the contribution in excess of that property's fair market value, Petitioner can impose an excise tax for failing to meet minimum funding standards. Nothing in Code § 4971 prohibits an employer from contributing noncash property.

3. Code § 404 permits a deduction for noncash contributions

Code § 404(a) provides the statutory rules for when an employer may claim a tax deduction for its plan contributions. In a precursor to her litigating position here, Petitioner argued, before Congress enacted ERISA, that no deduction should be allowed under Code § 404(a) for contributions to a plan unless such contributions were in cash. The courts rejected Petitioner's argument since no such requirement appears anywhere in the statutory

language.[2] Petitioner later acquiesced in this result. *See, e.g., Colorado Nat'l Bank v. Commissioner*, 30 T.C. 933 (1958), *acq.*, 1959-1 Cum. Bull. 3; Rev. Rul. 73-345, 1973-2 Cum. Bull. 11; Rev. Rul. 75-498, 1975-2 Cum. Bull. 29.[3] Nothing in ERISA changed the pre-ERISA rule that noncash contributions are deductible. It is inconceivable that Congress would grant a tax deduction for a noncash contribution if Congress intended to classify such a contribution as a "prohibited transaction."

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[2] Code § 404 is in fact a "limiting" provision. Contributions are deductible under Code § 404 only to the extent that they would be otherwise deductible under the Code. Under Code § 83, however, transfers of property by an employer are not deductible unless and until the employees take such property into income. Congress, however, recognized that employers routinely contribute noncash property to pension plans. Therefore, Code § 83(e)(2) explicitly states that Code § 83 does not apply to "a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2)." The Code therefore "explicitly contemplates" that employers would make noncash contributions to pension trusts. Edward A. Zelinsky, *Pensions and Property Contributions: Wood, Keystone, and the Supreme Court*, 56 Tax Notes 651, 655 (1992).

[3] The only form of property that does not constitute a deductible "payment" under Code § 404 is an employer's own promissory note. In *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 (1977), this Court held that an employer could not claim a deduction for contributing its own promissory note to a plan because Code § 404 permits a deduction only when a contribution is actually "paid." The dissent in *Williams* noted that the Commissioner "concedes that the petitioner could have obtained its deductions had it tendered to the trust identical notes of a different company, for such a transaction would have been treated as a deductible transfer of property." *Williams*, 429 U.S. at 587 (Stewart, J. dissenting).

B. Code § 4975 Does Not List A Contribution Of Unencumbered Property As A Prohibited "Sale Or Exchange"

Code § 4975(c) contains a "specific" list of transactions that Congress prohibited per se. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 321 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5101. The statutory language makes it clear that the purpose of Code § 4975 was to protect the assets of a plan once those assets have been contributed. The statute reads:

> (1) GENERAL RULE – For purposes of this section, the term "prohibited transaction" means any direct or indirect –
>
> (A) sale or exchange, or leasing, of any property between a plan and a disqualified person;
>
> (B) lending of money or other extension of credit between a plan and a disqualified person;
>
> (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
>
> (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
>
> (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
>
> (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from

> any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

Code § 4975(c)(1)(A) thus prohibits an employer from engaging in a "sale or exchange, or leasing, of any property" with a plan, regardless of whether the employer is the buyer or seller. Code § 4975(c)(1)(D) then prohibits a plan from transferring its "income or assets" to an employer. A transfer of property from an employer to a plan is *not* listed as a prohibited transaction.

If Congress had intended to prohibit contributions of property from an employer to a defined benefit plan, Congress could have, and would have, done so without confusion. Code § 408(a)(1), dealing with contributions to individual retirement accounts ("IRAs"), states that "no contribution will be accepted unless it is in cash." The prohibited transaction rules of Code § 4975 expressly apply to IRAs. Code § 4975(e).

Congress enacted the provision requiring cash contributions to IRAs as part of ERISA in the same bill as Code § 412 and Code § 4975. The legislative history of ERISA, while saying nothing to suggest that employers were required to make cash contributions to pension plans, states that "[C]ontributions [to IRAs] must be made in cash (currency, checks, etc.), and contributions in property are not to be deductible." H.R. Rep. No. 779, 93rd Cong., 2d Sess. 127 (1974), *reprinted in* 1974-3 Cum. Bull. 244, 370. The Congress that enacted the funding rules and the prohibited transaction rules thus knew how to require cash contributions. If Congress had intended to apply the same cash restriction to defined benefit plans, it would have stated that restriction in plain language, as it did with IRAs.

C. Code § 4975(f)(3) Demonstrates That Congress Did Not Intend To Prohibit Noncash Contributions

In language that is dispositive of this case, Code § 4975(f)(3) states:

> A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

The property that Respondent transferred to the Trust that is the subject of this case was not "subject to a mortgage or similar lien." Thus, as the Tax Court and the Fifth Circuit correctly held, the transfer of property by Respondent to the Trust was not a "sale or exchange" within the intendment of Code § 4975.

The legislative history of ERISA explains the purpose behind Code § 4975(f)(3). Both the Senate and Conference Reports state that Congress enacted Code § 4975(f)(3) to prevent an employer from mortgaging property before contributing it to a plan. Such a transaction would enable the employer to remove cash equity from the property and then force the plan later to use its cash assets to repay the mortgage. The applicable Senate Report (and a nearly identical provision in the Conference Report) states as follows:

> [A] transfer of property by a party in interest to a trust is treated as a sale or exchange if the property is subject to a mortgage or similar lien

> which the party in interest placed on the property within 10 years of the transfer to the trust, or if the trust assumes a mortgage or similar lien placed on the property prior to transfer. *This rule prevents circumvention of the prohibition on sale by mortgaging the property before a transfer to the trust.*

S. Rep. No. 383, 93rd Cong., 1st Sess. 98 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4890, 4981 (emphasis added); *see also* H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5088. This legislative history is irreconcilable with Petitioner's definition of a "sale or exchange" because it obviously contemplates that employers would make noncash contributions.

Code § 4975(f)(3) dovetails with Code § 4975(c)(1)(A). Under the ordinary, everyday definition of a "sale or exchange," Code § 4975(c)(1)(A) prevents an employer from selling property to a pension plan in exchange for plan assets. If an employer uses property as security for a loan, receives the loan proceeds, and then contributes the property subject to the mortgage to the plan, the plan will be required to use its own assets to repay the mortgage or lose the property. Since the plan will have to repay the loan made to the employer, contributions of mortgaged property represent an opportunity for an employer to extract assets from a pension plan. Congress thus classified contributions of mortgaged property as a prohibited "sale or exchange."

Code § 4975(f)(3) would be superfluous if Congress intended to incorporate the income tax definition of a "sale or exchange" into Code § 4975. Under the income tax rules, *any* transfer or contribution of property from an

employer to a pension plan is a "sale or exchange," even if the contribution is not in satisfaction of an "indebtedness." *See, e.g., Tasty Baking Co. v. United States*, 393 F.2d 992, 995 (Ct. Cl. 1968); *A.P. Smith Mfg. Co. v. United States*, 364 F.2d 831, 838 (Ct. Cl. 1966), *cert. denied*, 385 U.S. 1003; *United States v. General Shoe Corp.*, 282 F.2d 9, 12 (6th Cir. 1960), *cert. denied*, 365 U.S. 843 (1961); *International Freighting Corp. v. Commissioner*, 135 F.2d 310 (2d Cir. 1943). Moreover, any transfer of property subject to a mortgage that the transferee assumes, or any transfer of property subject to a nonrecourse indebtedness, is a "sale or exchange" *between the transferor and the transferee* because the transferee will have to pay off the indebtedness with its own assets or relinquish the property. The amount of the mortgage is included in the transferor's amount realized from the sale (plus any other consideration paid), and the transferee takes the property with a tax basis equal to the amount of the mortgage. *See Commissioner v. Tufts*, 461 U.S. 300, 307-10 (1983); *Crane v. Commissioner*, 331 U.S. 1, 13-14 (1947); Rev. Rul. 81-163, 1981-1 Cum. Bull. 433; Rev. Rul. 70-626, 1970-2 Cum. Bull. 158.

Both the Tax Court and the Fifth Circuit realized that Code § 4975(f)(3) would be meaningless if Congress intended to prohibit noncash contributions to a defined benefit pension plan under Code § 4975(c)(1)(A). Petitioner, however, argues that these courts erred because Code § 4975(f)(3) was intended to "expand," rather than "limit," the definition of a "sale or exchange" under Code § 4975. Since the Fifth Circuit and the Tax Court viewed Code § 4975(f)(3) as a limiting provision, Petitioner argues that both courts misinterpreted the statute.

Petitioner's argument is a smokescreen. When Congress enacted Code § 4975(c)(1)(A), it did not intend to treat a "contribution" of noncash property as a prohibited transaction. Respondent thus agrees that Congress enacted Code § 4975(f)(3) to *expand* the definition of a "sale or exchange" to include a contribution of encumbered property. But by "expanding" Code § 4975(c)(1)(A) in this way, the statutory language demonstrates that a contribution of unencumbered property is *not* a prohibited "sale or exchange" under Code § 4975(c)(1)(A). Whether one describes Code § 4975(f)(3) as an "expansion" or as a "limitation" thus is an exercise in semantics that offers no help in discerning Congress's intent.

1. Petitioner's interpretation of Code § 4975(c)(1)(A) renders Code § 4975(f)(3) both superfluous and ineffective

Petitioner's attempt to explain why her interpretation of Code § 4975(c)(1)(A) does not render Code § 4975(f)(3) meaningless is contrived and convoluted. Petitioner argues that Congress enacted Code § 4975(f)(3) to cover so-called "voluntary" transfers of property to a plan, i.e., transfers not in satisfaction of a current statutory funding obligation. Such voluntary transfers arise either because (i) the employer contributes more than the minimum amount necessary to meet that year's funding obligation (in the case of a defined benefit plan) or (ii) the employer has no fixed liability to contribute a particular amount of property (in the case of certain types of defined contribution plans).

Petitioner in her opening brief recognizes that even a "voluntary" transfer is a "sale or exchange" under the Internal Revenue Code. She therefore argues that a "voluntary" transfer should be viewed as a "sale or exchange" between the employers and employees and that Congress enacted Code § 4975(f)(3) to convert a "sale or exchange" between an employer and an employee into a "sale or exchange" between an employer and a plan.[4]

As enacted, the language of Code § 4975(f)(3) clearly indicates that Congress did not intend to change the pre-ERISA rule that an employer could contribute any type of property to a pension plan. To conclude, as Petitioner has, that Code § 4975(f)(3) was necessary because, in Petitioner's view, a "voluntary" contribution to a plan is a "sale or exchange" between the employer and the employees, with not a hint of supporting language in either the statute or the legislative history, is to conclude that Congress purposefully included hidden meaning in

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[4] Petitioner's argument that a "voluntary" contribution of *unencumbered* property should be viewed as a "sale or exchange" between the employers and the employees is unsupported by the case law. The pre-ERISA cases holding that a contribution of unencumbered property to a pension plan was a "sale or exchange" involved "voluntary" contributions. *Tasty Baking Co.*, 393 F.2d 992; *A.P. Smith Mfg. Co.*, 364 F.2d 831; *General Shoe Corp.*, 282 F.2d 9; *International Freighting Corp.*, 135 F.2d 310. In none of these cases did the courts state who the "sale or exchange" was "between." The only relevant issue was whether there had been a "sale or exchange" at all. Since both "voluntary" and "involuntary" contributions are made *to the plan* in consideration for services to employees, there is no authority for the Petitioner's alleged distinction between "voluntary" and "involuntary" contributions.

the statute and intended to mislead employers who maintain defined benefit plans. Congress would not have enacted a statute that contains such an obviously erroneous implication.

Nothing in Code § 4975(f)(3) or the legislative history suggests that Congress intended Code § 4975(f)(3) to apply only to limited types of transfers, and nothing in Code § 4975 or the legislative history even hints at different rules for so-called "voluntary" transfers and "involuntary" transfers. Moreover, Code § 4975(f)(3) merely states that a transfer of mortgaged property "shall be treated as a sale or exchange." Thus, if Congress enacted Code § 4975(f)(3) to convert a "sale or exchange" between an employer and employees into a "sale or exchange" between an employer and a plan, Congress failed miserably. Code § 4975(f)(3) would have to state that a transfer of mortgaged property "shall be treated as a sale or exchange between a plan and a disqualified person" in order for the provision to accomplish what Petitioner states it was intended to accomplish.

More important, Petitioner's proposed distinction between "voluntary" and "involuntary" transfers of property destroys the cornerstone of her position, namely her argument that the words "sale or exchange" should be given the same definition throughout the Internal Revenue Code. As stated earlier, under the income tax law a transfer of property subject to a mortgage is a "sale or exchange" between the transferor and the transferee. *See Tufts*, 461 U.S. at 307-10; *Crane*, 331 U.S. at 13. Because the recipient of the property must pay the indebtedness or lose the property, the transferee provides consideration to the transferor for the property. The transferor treats the

mortgage as part of its amount realized and the transferee treats the mortgage as part of the property's purchase price.

Petitioner's explanation of Code § 4975(f)(3) is therefore wrong. Based on the income tax law, she asserts that Congress intended for a contribution of property in satisfaction of a funding requirement to be a prohibited transaction under Code § 4975(c)(1)(A). In order to render Code § 4975(f)(3) not superfluous, however, she wants this Court to disregard that same case law and hold that a contribution of property "subject to a mortgage or similar lien that the Plan assumes" would not be a "sale or exchange" between an employer and a plan except for Code § 4975(f)(3). Petitioner cannot have it both ways. The rationale for treating a transfer of property in satisfaction of an indebtedness as a "sale or exchange" between the transferor and the transferee is the exact same rationale for treating a transfer of property subject to a mortgage as a "sale or exchange" between the transferor and the transferee. As this Court has noted, the rationale in both contexts is that the transferor has received an "immediate economic benefit" because the transferor is relieved of an indebtedness. *See Diedrich v. Commissioner*, 457 U.S. 191, 196-97 (1982). Code § 4975(f)(3) therefore is unequivocally superfluous under the Petitioner's interpretation of Code § 4975(c)(1)(A).

2. Petitioner's voluntary/involuntary distinction highlights the absurdity of her statutory interpretation

Under Petitioner's interpretation of Code § 4975(c)(1)(A), a contribution to a plan is a prohibited

"sale or exchange" when the contribution satisfies a statutory minimum funding standard *for that year*[5] under Code § 412. When an employer makes a contribution to a defined benefit plan that is not necessary to satisfy a minimum funding obligation, however, the employer increases the assets of the pension trust, receives a credit in its Code § 412 funding standard account, and may thereby reduce its funding obligation in future years.

For example, suppose Company A has a minimum funding requirement of $1,000 in 1993 and expects to have a minimum funding requirement of approximately $1,000 in 1994. Under Petitioner's view, both of these contributions, if made in 1993 and 1994 respectively, must be made in cash. But if Company A chooses to contribute $2,000 in noncash property in 1993, $1,000 of this contribution would not be in satisfaction of any liability because the funding obligation under Code § 412 had not yet arisen. Indeed, since the funding obligation in a future year will depend on (i) investment performance of the trust's other assets, (ii) services provided by employees, and (iii) whether the employer chooses to terminate the plan, the liability in 1994 might never arise.

Petitioner agreed in the Fifth Circuit that any contribution in excess of a current funding obligation was not a prohibited "sale or exchange." Reply Brief for the Appellant at 9 n.2. The court then concluded that Petitioner's

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[5] Code § 412(a) states that "[a] plan to which this section applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year, the plan does not have an accumulated funding deficiency."

distinction between "voluntary" and "involuntary" contributions was economically irrational because there is no reason why Congress would distinguish between contributions that satisfy a current funding obligation and contributions that increase the employer's funding standard account but do not satisfy a current funding obligation. *Keystone Consolidated Industries v. Commissioner*, 951 F.2d 76, 78 (5th Cir. 1992).

Petitioner now states in footnote 6 of her brief that the Fifth Circuit's conclusion that the voluntary/involuntary distinction was economically irrational, "while relevant to defined benefit pension plans," ignores the fact that contributions to certain types of defined contribution plans do not have the effect of reducing a future funding obligation and are therefore truly "voluntary." Pet. Br. at 6 n.6. Petitioner's statement is ambiguous. Perhaps Petitioner now believes that all contributions to a defined benefit plan are a prohibited "sale or exchange" because even a contribution in excess of a current funding obligation is likely to satisfy a future funding obligation. Alternatively, Petitioner might be arguing, as she did before the Fifth Circuit, that a contribution to a defined benefit plan in excess of a current funding obligation would be a "voluntary" contribution.[6]

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[6] Petitioner also argues that "voluntary" contributions to defined benefit pension plans are "largely a nonissue" since such contributions (whether in cash or other property) are subject to a 10-percent excise tax under Code § 4972. Pet. Br. at 24 n.15. The issue here is what Congress intended when it enacted Code § 4975 in 1974. The excise tax imposed by Code § 4972 on

If Petitioner's evolving position now is that no contribution to a defined benefit plan can ever be "voluntary," then she is wrong. The minimum funding standards imposed by Code § 412(a) are based solely on an annual accounting. As stated above, the future liability will never arise if, for example, the plan were terminated or the value of plan assets increased substantially. The assertion that all contributions to defined benefit plans are "involuntary" ignores the fact that, in a real sense, such contributions are not currently required and may never be required.

If Petitioner wishes to continue to argue that contributions to a defined benefit plan in excess of a current funding obligation are "voluntary" contributions, then her assertion in footnote 6 that some contributions to defined contribution plans are truly "voluntary" misses the point. If Congress had intended to prohibit an employer from meeting a current funding obligation with a contribution of noncash property, there is no reason

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"voluntary" contributions to a defined benefit plan was not enacted until 1986 and was not effective until 1987.

Petitioner's factual assertion that there are no "voluntary" contributions to a defined benefit plan because of Code § 4972 is also inaccurate. Code § 4972 imposes an excise tax only on *nondeductible* contributions. Code § 412, however, contains both minimum funding standards and full funding limitations. A contribution becomes nondeductible only if it exceeds the full funding limitation. An employer thus can make a deductible contribution greater than its minimum funding requirement while still within its full funding limitation. Such a contribution, under the Petitioner's view, would be "voluntary" and not required to be made in cash even though it is deductible for income tax purposes.

why Congress would permit noncash contributions when such contributions will increase the employer's funding standard account and could thereby reduce the amount of required contributions in future years. The fact that there can also be "voluntary" contributions to a defined contribution plan does not explain why Congress would treat "voluntary" and "involuntary" contributions to a defined benefit plan differently.

At bottom, this whole discussion exemplifies why Petitioner's interpretation of Code § 4975 cannot be right. Because (i) the income tax laws do *not* distinguish between "voluntary" and "involuntary" contributions, (ii) a transfer of property subject to a mortgage is a "sale or exchange" between the transferor and transferee, and (iii) the distinction between a "voluntary" and an "involuntary" contribution is so murky, Petitioner's assertion that Congress focused on the voluntary/involuntary distinction in drafting Code § 4975(c)(1)(A) and Code § 4975(f)(3) is incredible. If Congress had focused on this distinction, surely there would be some express indication of the distinction in the statutory language or legislative history. Absent some indication in the statute or legislative history that Congress intended that an "involuntary" contribution of property would be a prohibited "sale or exchange" between an employer and a plan, while a "voluntary" contribution would be merely a "sale or exchange" between the employer and its employees, it is absurd for Petitioner to assert that Congress drafted Code § 4975(f)(3) based on that distinction.

D. Petitioner's Analogy To The Income Tax Laws Is Inapposite. Code § 4975 Imposes An Excise Tax

The Internal Revenue Code requires a taxpayer to recognize gain or loss on a disposition of property when the disposition occurs in a "sale or exchange." Code § 1001(c). Because the finding of a "sale or exchange" is essential to the recognition of gain or loss, courts have interpreted the words "sale or exchange" broadly. For example, under the income tax case law, *any* transfer of property (whether or not in satisfaction of a funding requirement) from an employer to a pension trust is a "sale or exchange." *See, e.g., Tasty Baking Co.*, 393 F.2d at 995; *A.P. Smith Mfg. Co.*, 364 F.2d at 838; *General Shoe Corp.*, 282 F.2d at 12; *International Freighting Corp.*, 135 F.2d 310. When an employer contributes property to a plan, the employer is entitled to a deduction in an amount equal to the fair market value of the property at the time of the contribution. Code § 404(a). If the contribution were not treated as a "sale or exchange" for income tax purposes, the employer's taxable income would either be overstated or understated, depending on whether the property had appreciated or depreciated in value at the time of the contribution.

In contrast to the income tax rules, Code § 4975 does not purport to measure or tax economic income. Code § 4975 was enacted as part of ERISA to prevent "specific prohibited transactions" by making them subject to heavy penalty taxes. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 321 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5101. Since the legislative purpose of Code § 4975 is so unrelated to the policies behind the income tax rules, the

definition of a "sale or exchange" under the income tax laws is of little relevance when interpreting Code § 4975. Indeed, this Court has stated unequivocally that the word "sale" has many meanings under the Internal Revenue Code, depending on the statutory purpose for that use. *Helvering v. Hammel*, 311 U.S. 504, 507 (1941) ("The term sale may have many meanings, depending on the context . . . . The meaning here depends on the purpose with which it is used in the statute and the legislative history of that use.") For example, in *United States v. Davis*, 370 U.S. 65 (1962), this Court held that a division of property pursuant to a voluntary settlement agreement was to be treated as a "sale or exchange" for income tax purposes, even though the same transaction was *not* treated as a "sale or exchange" under the gift and estate tax statutes. *Id.* at 69 n.6 ("In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes.").

Petitioner's analogy to the income tax rules, if applied to Code § 4975, leads to an absurd result. Petitioner's fundamental premise is that a transfer of property in satisfaction of a statutory funding obligation should be treated as a "sale or exchange" of that property because the transfer relieves the employer of an "indebtedness." Summarizing her position, she states:

> At the least, the contribution of property in satisfaction of a funding obligation is a type of sale of the property. It is equally surely a form of exchange, since the property is exchanged for

diminution of the employer's funding obligation.

Pet. Br. at 17.

Petitioner's definition of a "sale or exchange" cannot be what Congress intended. *Money is property*. Code § 4975(f)(4), in fact, refers on two occasions to "money and the fair market value of the *other* property" (emphasis added). If, therefore, the "contribution of property in satisfaction of a funding obligation is a type of sale of the property" within the meaning of Code § 4975, a contribution of cash in satisfaction of a funding obligation would be a prohibited "sale or exchange."

Petitioner's position is not improved by inserting the word "noncash" before the word "property." The rationale underlying her interpretation of a "sale or exchange" applies equally to both cash and noncash property. Under Petitioner's interpretation of Code § 4975(c)(1)(A), a contribution of "property" in satisfaction of a statutory funding obligation is a "sale or exchange" because the pension plan gives up its right to collect a contribution in an "exchange." If an employer transfers cash to comply with a statutory funding obligation, the employer has engaged in "a form of exchange, since the property is exchanged for diminution of the employer's funding obligation." Pet. Br. at 17. The plan gives up its legal right to a contribution regardless of whether the employer contributes cash or noncash property.[7]

[7] Whether the satisfaction of a debt with cash would constitute a "sale or exchange" under the income tax laws is generally irrelevant because the tax basis of cash is always equal to its fair market value. Therefore no gain or loss would ever be recognized. The issue here, however, is whether a contribution of property constitutes a "sale or exchange," not whether an employer should recognize gain or loss on a contribution. Given that Code § 4975 treats money as "property," a contribution of property cannot be a "sale or exchange."

The fact that Petitioner's interpretation of a "sale or exchange" applies equally well to cash and noncash property demonstrates that Congress did not enact Code § 4975(c) to regulate contributions to pension plans. Congress enacted Code § 4975 to prevent an insider from *extracting* assets from a pension plan, not to prevent an insider from *contributing* assets to a pension plan. *See* Edward A. Zelinsky, *Pensions and Property Contributions: Wood, Keystone, and the Supreme Court*, 56 Tax Notes 651, 656 (1992). Consistent with that purpose, each of the prohibited transactions listed in Code § 4975(c) is a transaction that could allow an employer to extract assets from a pension trust after those assets have been contributed. For example, if an employer sells property to a pension trust in an ordinary "sale or exchange," the trust must transfer assets that it had previously received in exchange for the property. By contrast, a contribution of property, whether cash or noncash, represents an infusion of assets into the plan, not the extraction of assets from a plan.

II. CODE § 4975 IS A PENALTY TAX THAT APPLIES ONLY IF THE WORDS OF THE STATUTE "PLAINLY IMPOSE IT"

A. Code § 4975 Must Be Strictly Construed

Code § 4975 is a penal statute that imposes harsh sanctions against employers that violate its provisions. As

Petitioner states, the statute imposes a "heavy, two-tier tax," Pet. Br. at 13, consisting of a 5% first-tier tax and a 100% second-tier tax. These taxes make "illegal per se" each of the prohibited transactions. *Donovan v. Cunningham*, 716 F.2d 1455, 1464-65 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984). *See also Nieto v. Ecker*, 845 F.2d 868, 874 n.6 (9th Cir. 1988) (Code § 4975 imposes a "civil penalty"). In this case, the civil penalty imposed by Code § 4975 is staggering. Petitioner has assessed approximately $4 million in penalties under the first-tier tax and approximately $9 million under the second-tier tax. In contrast, the maximum criminal penalty for a corporation under ERISA is $100,000. ERISA § 501, 29 U.S.C. 1131.

Statutes imposing penalty taxes must be given a strict construction. In *Commissioner v. Acker*, 361 U.S. 87, 91 (1959), this Court said:

> We are here concerned with a taxing Act which imposes a penalty. The law is settled that "penal statutes are to be construed strictly," *Federal Communications Comm'n v. American Broadcasting Co.*, 347 U.S. 284, 296, and that one "is not to be subjected to a penalty unless the words of the statute plainly impose it," *Keppel v. Tiffin Savings Bank*, 197 U.S. 356, 362.

This Court relied on *Acker* as recently as last term in giving a narrow construction to a $200 penalty tax imposed on any manufacturer "making" a "firearm." *United States v. Thompson/Center Arms Co.*, 112 S.Ct. 2102, 2110 (1992).

Respondent believes that Code § 4975 "plainly" *permits* noncash contributions of unencumbered property. The Fifth Circuit and the Tax Court agreed, ruling that a

"contribution" in satisfaction of a statutory funding obligation is not a prohibited "sale or exchange" between an employer and a plan. Both courts reached that conclusion without relying on the requirement that courts must construe penal provisions strictly. The fact that both the Fifth Circuit and the Tax Court ruled for Respondent without applying a narrow construction of Code § 4975 demonstrates that Code § 4975 does not "plainly impose" a penalty tax on contributions of unencumbered property.

Petitioner argues that a "contribution" of property clearly is a prohibited "sale or exchange" since the statute prohibits any "direct or indirect" sale or exchange. No case, however, even under the broadly interpreted income tax laws, has ever suggested that the contribution of property from an employer directly to a pension plan constitutes an "indirect" sale or exchange. Rather, every case interpreting the term "indirect" under the income tax laws, symmetry with which the Petitioner finds essential, has held that an "indirect" transaction is a transaction effected through an intermediary such as a broker, stock exchange, or straw man. *See, e.g., McWilliams v. Commissioner*, 331 U.S. 694 (1947); *Shethar v. Commissioner*, 28 T.C. 1222 (1957); *Estate of Estroff v. Commissioner*, 47 T.C.M. (CCH) 234 (1983).[8] The two references in the legislative history of Code § 4975 to an "indirect" transaction adopt a similar interpretation, describing an "indirect"

[8] These courts are always careful to point out that the definition of an "indirect" sale or exchange may not be strictly limited to a sale through an intermediary. However, an actual sale through an intermediary appears to be the only type of "indirect" sale ever identified in the case law.

transaction as a transaction effected through a middleman or a related party.[9] Petitioner should not be able to impose $13 million in penalties against Respondent based on an interpretation of the word "indirect" that lacks any support in either case law or legislative history.

B. Petitioner Has Admitted That A Contribution Of Property To A Defined Benefit Plan Is Not A Prohibited Transaction

Any assertion by Petitioner that Code § 4975 "plainly" applies to a contribution of property is outrageous. Petitioner has acknowledged in her own words that the statutory language is, at a minimum, highly ambiguous. In 1978, an employer sought a private ruling from Petitioner that the contribution of noncash property was not a prohibited transaction under Code § 4975. Petitioner, who was authorized at that time to issue regulations under Code § 4975,[10] responded that "the question

[9] The Conference Report describes two "indirect" transactions. The first such transaction is the sale of property by an employer to a mutual fund under an arrangement in which the employer's pension plan would then invest in the mutual fund. The legislative history refers to this as an "indirect" sale. The second example is a pension plan that invests in a joint venture that owns an office building and leases it to the employer who set up the pension plan. The legislative history refers to this as an "indirect" lease. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 309-10 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5089-90. These two examples demonstrate that an "indirect" transaction is a transaction through an intermediary.

[10] Regulatory authority under Code § 4975(c) was transferred from the Department of Treasury to the DOL at the end of 1978. Section 102 of Reorganization Plan No. 4 of 1978, 92 Stat. 3790.

of whether the contribution of property other than cash by an employer to his plan constitutes a prohibited transaction as defined by section 4975(c)(1) of the Code, presents an issue that cannot reasonably be resolved prior to the issuance of regulations." Private Letter Ruling 7852116 (Sept. 29, 1978).

Even though Petitioner never promulgated any regulations, Petitioner later "resolved" the issue. Until late 1989 the chapter of the Internal Revenue Manual dealing with contributions of property to *defined benefit plans* stated as follows:

> If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, if the plan permits the contribution to be made in cash or in kind *no prohibited transaction would occur.* (Note special rules under 4975(f)(3) of the code for encumbered property).

Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 324.1(2) (July 15, 1988) (emphasis added) (attached as Appendix A). The Internal Revenue Manual is Petitioner's internal policy manual, available to the public, that is designed to inform revenue agents of Petitioner's administrative positions. Thus, at the same time that Petitioner was seeking $13 million in penalties against Respondent because of a contribution of noncash property to a defined benefit plan, Petitioner was notifying the revenue agents who audit employers that a contribution of noncash property to a defined benefit plan was *not* a "sale or exchange."

Petitioner made a minor adjustment in the Internal Revenue Manual in late 1989. The text *currently* reads:

> If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, even if the plan permits the contribution to be made in cash or in kind a prohibited transaction *may* still occur. (Note special rules under 4975(f)(3) of the code for encumbered property).

Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 324.1(2) (August 24, 1989) (emphasis added) (attached as Appendix B). At a later point in the Manual, Petitioner explains her interpretation of Code § 4975(f)(3) and then explains what she means by the word "may." Petitioner states:

> If a disqualified person transfers real or personal property to a plan, that transfer constitutes a sale or exchange such as to make the transfer a prohibited transaction if:
>
> (1) the property is subject to a mortgage or lien which the plan assumes; or
>
> (2) the plan takes the property subject to a mortgage or similar lien which was placed on the property by a disqualified person within 10 years prior to the transfer. [IRC 4975(f)(3)]
>
> Such a transfer of real or personal property will most often arise in the context of a contribution of property other than cash by the employer. It should be noted that the issue of whether a contribution of property, even though unencumbered, by an employer constitutes an exchange within the definition of a prohibited transaction, *has not yet been decided by the Service.*

Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 723 (July 15, 1988) (emphasis added) (attached as Appendix C). The *current* version of the Internal Revenue Manual thus states that Petitioner has not yet decided the correct result in this case.

Respondent acknowledges that the Internal Revenue Manual is not legally binding on Petitioner. The issue here, however, is whether the statutory language is sufficiently unambiguous to justify $13 million in penalties. Because Petitioner herself admits that the statutory language is confusing and in fact offered the same interpretation as Respondent until 1989, the statutory language obviously does not so justify. If Petitioner now believes that policy considerations compel her to assert that noncash contributions should be prohibited, Petitioner should go to Congress with those concerns or should issue regulations under Code § 412 requiring cash contributions (on a prospective basis in compliance with the Administrative Procedure Act). Under no circumstances, however, should Petitioner be permitted to regulate retroactively to the detriment of one particular taxpayer.

III. PETITIONER'S BROAD INTERPRETATION OF CODE § 4975 FINDS NO SUPPORT IN LEGISLATIVE HISTORY, POLICY OR AGENCY "INTERPRETATION"

A. The Legislative History Of Code § 4975 Expresses No Intention To Treat A Contribution Of Property As A Prohibited "Sale Or Exchange"

Prior to the enactment of ERISA, the contribution of noncash property to pension plans was common. Petitioner argued that such contributions should not be deductible, but lost the issue and then acquiesced. *Colorado Nat'l Bank v. Commissioner*, 30 T.C. 933 (1958), *acq.*, 1959-1 Cum. Bull. 3; Rev. Rul. 73-345, 1973-2 Cum. Bull. 11; Rev. Rul. 75-498, 1975-2 Cum. Bull. 29. The Internal Revenue Manual, in fact, states that contributions of noncash property still are common today. Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 324.3(1) (Jan. 30, 1989) ("employers will often transfer stock, bonds, mortgages, and other personal property or real property directly to the trust").

If Congress had intended to change pre-ERISA practice, Congress would have expressed its intent in legislative history. This Court consistently has refused to interpret statutory language so as to effect a major change in law "that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 112 S. Ct. 773, 779 (1992); *see also Finley v. United States*, 490 U.S. 545, 554 (1989) (changes in law are not to be inferred unless such intent is clearly expressed). A change in the type of property that an employer can contribute to a

defined benefit pension plan constitutes a "major change" that would warrant some explicit mention in the legislative history. No such mention exists.

The Conference Report for ERISA is divided into fourteen sections. Section IV is labelled "FUNDING." H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 282 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5063. Nothing in Section IV in any way suggests that an employer must meet its funding responsibilities with cash contributions. Section V is labelled "FIDUCIARY RESPONSIBILITY" and includes a description of the prohibited transaction rules. *Id.* at 294, *reprinted in* 1974 U.S.C.C.A.N. at 5075. Again, nothing in Section V suggests that Congress intended to prohibit noncash contributions.[11] To the contrary, in at least two places Section V demonstrates that Congress did not intend for the words "sale or exchange" to include a "contribution."

As explained earlier, the legislative history of Code § 4975(f)(3) states that the purpose of that provision was to prevent an employer from disguising a sale of property by mortgaging that property and then contributing it to the plan. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5088. No mention is made of a different rule for contributions to a defined benefit plan. The fair and logical reading of this

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[11] The House and Senate Reports contain nearly identical divisions. H.R. Rep. No. 533, 93rd Cong., 1st Sess. (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639; S. Rep. No. 383, 93rd Cong., 1st Sess. (1973), *reprinted in* 1974 U.S.C.C.A.N. 4890. Nothing in either Report suggests that Congress intended to prohibit noncash contributions.

legislative history is that Congress did not intend to change settled practice with respect to contributions of unencumbered property to defined benefit plans.

The legislative history of Code § 4975(c)(1)(B) is equally irreconcilable with Petitioner's position. Code § 4975(c)(1)(B) states that it is a prohibited transaction for an employer to engage in the "lending of money" with a plan. According to the legislative history, one purpose of this rule was to prevent employers from satisfying their funding obligations to a plan with a promissory note since the employer would then be indebted to the plan. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5088. A promissory note is noncash property. If Congress intended to create a "categorical" rule that a contribution of noncash property was a prohibited "sale or exchange," this legislative history makes no sense. A contribution of a promissory note would be a prohibited transaction under Code § 4975(c)(1)(A) regardless of Code § 4975(c)(1)(B).[12]

B. The Existing Statutory Structure Adequately Addresses Petitioner's Policy Concerns

Petitioner argues that contributions of noncash property create an opportunity for employers to take advantage of pension plans by overstating the value of those contributions. The existing statutory scheme, however,

[12] The fact that it is a prohibited transaction under Code § 4975 for an employer to contribute its own notes to a plan is entirely consistent with the rule that such contributions are *not* deductible under Code § 404. *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 (1977).

directly addresses the concerns raised by Petitioner. If an employer contributes property to a plan to satisfy its minimum funding obligation and the employer overstates the value of those contributions, Petitioner can impose penalty taxes against the employer under Code § 4971 because the plan would have an accumulated funding deficiency. In addition, to the extent that the plan's funding level was then inadequate, the employer's statutory obligations in subsequent years would be increased.

Petitioner also argues that contributions of noncash property interfere with the trustee's right to select the investment assets of the pension trust. This is incorrect. The trustee has the authority to refuse to take title to any contributed property. *See* Pet. Br. at 19 n.11. If the trustee disapproves of the property that the employer wants to contribute, the trustee can refuse to accept it. The employer then must contribute other noncash property or cash. As an alternative, the trustee can accept the property and then sell it. Permitting an employer to contribute noncash property thus does not interfere with the trustee's right to select the trust's investments.

Petitioner's final policy argument is that contributions of noncash property effectively transfer the expenses of selling property to the trust from the employer. Again, this is inaccurate. Any expenses or commissions paid by the trust when selling contributed property will reduce the fair market value of trust assets and thus increase the employer's funding obligations under Code § 412. The employer, not the trust, thus bears the economic cost of selling property.

There are several policy reasons why Congress would *permit* noncash contributions. Defined benefit plans offer far more economic protection to employees than defined contribution plans because the investment risk of a defined benefit plan rests with the employer. *See* Edward A. Zelinsky, *Pensions and Property Contributions: Wood, Keystone and the Supreme Court*, 56 Tax Notes 651, 657 (1992). To the extent property declines in value the employer, not the employees, bears the economic burden. If noncash contributions to defined benefit plans are prohibited but are permitted with respect to plans where the employer has complete discretion whether to make contributions, employers would have an incentive to terminate their defined benefit plans and would adopt, for example, profit-sharing plans or similar plans that offer little retirement security.

Banning noncash contributions also would make it more difficult for employers to make their contributions. If an employer were strapped for cash and bank credit were unavailable, it certainly would be reasonable for Congress to prefer that the employer make the contribution in noncash property rather than not at all. To the extent that the employer attempts to overvalue the contributed property, Petitioner can assess a penalty tax under Code § 4971 and the employer's required contributions in later years would be greater.

Policy considerations in this case thus cut both ways. If Petitioner, the DOL and the Pension Benefit Guaranty Corporation believe that policy considerations now favor prohibiting noncash contributions, they should allow Congress to weigh the different considerations and then make a judgment. *See Chevron, U.S.A., Inc. v. Natural*

Resources Defense Council, 467 U.S. 837, 864 (1984) (policy arguments "are more properly addressed to legislators or administrators, not to judges"). And where the meaning of a statute is clear, as it is here, policy considerations are irrelevant. *See Badaracco v. Commissioner*, 464 U.S. 386, 398 (1984).

C. This Court Should Not Defer To The Administrative Views Of The Petitioner And The Department Of Labor. Those Views Have Never Been Expressed In Regulations Or Published Rulings, Are Internally Inconsistent, And Are Based On A Faulty Premise

Petitioner argues that this Court should defer to her interpretation of Code § 4975 and the DOL interpretation of ERISA § 406, 29 U.S.C. 1106. These positions, however, have never been expressed in any published regulation or ruling and are internally inconsistent. Any deference would therefore be inappropriate.

When Congress enacted Code § 4975 in 1974, as noted above in footnote 10, regulatory authority rested with Petitioner. Petitioner chose not to issue regulations on whether a contribution of property was a prohibited transaction. Moreover, Petitioner has never published a single ruling, either public or private, treating a transfer of noncash property to a defined benefit plan as a prohibited transaction. The lone private ruling, as cited above, concluded that the issue could not be resolved without regulations. Private Letter Ruling 7852116 (Sept. 29, 1978).

Petitioner later published guidance for her revenue agents in the Internal Revenue Manual. As explained above, that guidance contradicts Petitioner's position in this litigation. Respondent believes it is an abuse of process for Petitioner to assert penalty taxes as a result of a 1983 transaction when Petitioner was advising her own revenue agents through 1989 that a "contribution" of unencumbered property to a defined benefit plan was not a prohibited "sale or exchange."[13]

Petitioner also suggests that this Court should show deference to the interpretation of the DOL. Again, this Court owes no such deference. As with Petitioner, the DOL has never acted on its authority to issue regulations.[14] The only views offered by the DOL of the term

[13] Petitioner cites two revenue rulings under Code § 4941, not Code § 4975, and states that these rulings are "instructive." Pet. Br. at 31. In those rulings the IRS ruled that a transfer of property to a private foundation in repayment of a loan from the private foundation was a prohibited "sale or exchange." Rev. Rul. 81-40, 1981-1 Cum. Bull. 508; Rev. Rul. 77-379, 1977-2 Cum. Bull. 387. In both rulings property was transferred to repay a *loan* from the private foundation. Employer contributions to a pension plan are governed by an existing statutory scheme that in no way imposes an obligation to make cash contributions and in fact permits contributions of property unless the property is mortgaged. The repayment of a loan from a private foundation, however, is not covered by any statutory scheme and presumably involves a loan agreement under which the debtor agrees to repay the debt in cash.

[14] ERISA § 406(a)(1)(E), 29 U.S.C. 1106(a)(1)(E), treats as a prohibited transaction the acquisition by a plan of "any employer security or employer real property." ERISA §§ 407, 29 U.S.C. 1107, and 408, 29 U.S.C. 1108, provide exceptions to § 406 for certain acquisitions of qualifying employer real property or

"sale or exchange" have come in the form of two unpublished advisory opinions, one of which was released after this litigation began. DOL Advisory Opinions 90-05A (March 29, 1990) and 81-69A (July 28, 1981). These advisory opinions are binding only on the parties thereto and do not have precedential effect. ERISA Procedure 76-1 § 10, 41 Fed. Reg. 36,281, 36,283 (1976). Given the Petitioner's statements in the Internal Revenue Manual, it seems that Petitioner found the DOL opinions unconvincing and chose to ignore them. As this Court recently stated, inconsistent positions of government agencies merit no deference. *See Estate of Cowart v. Nicklos Drilling Co.*, 112 S. Ct. 2589, 2597 (1992).

In these advisory opinions the DOL assumed that ERISA imposes an obligation to make cash contributions. In DOL Advisory Opinion 90-05A, for example, the DOL stated that "contributions in kind that relieve an employer of an obligation to make cash contributions . . . are prohibited exchanges under section 406(a)(1)(A)." The DOL apparently did not understand that there is no "obligation to make cash contributions." Nothing in ERISA requires that an employer contribute cash. The DOL's interpretation thus is circular. The agency believes that an employer must make cash contributions because noncash contributions are prohibited transactions. It

qualifying employer securities. The DOL issued regulations in 1980 under ERISA § 408 defining the term "acquisition" to include purchases, exchanges, *and* contributions, among others. 29 C.F.R. § 2550.408e(b) (1992). Thus, the DOL's regulations under ERISA § 408 distinguish between contributions on the one hand and purchases and exchanges on the other hand.

believes that noncash contributions are prohibited transactions because the employer must make cash contributions. As is the Petitioner, the DOL is hopelessly confused.

CONCLUSION

Code § 4975 imposes a penalty tax that must be strictly construed; its harsh sanctions cannot apply unless the words of the statute "plainly impose it." The words of the statute do not "impose it." To the contrary, Code § 4975 and the statutory provisions governing pension plan funding plainly permit an employer to contribute noncash property to a plan unless the property is mortgaged. The judgment of the Court of Appeals should be affirmed.

Dated: December 23, 1992

Respectfully submitted,

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APPENDIX A

Chapter 300
Detailed Techniques – Defined Benefit Plans

324 (2-13-81) 7(10)54
Contributions in the Form of Other Property

324.1 (7-15-88) 7(10)54
General

(1) When an employer makes a contribution in the form of property other than cash, all elements of the transaction should be carefully scrutinized by the specialist. There are numerous violations, including prohibited transactions, in this area. These violations occur not only with regard to the fair market value (FMV) of the property claimed as a deduction, but also as to whether the transferred asset is an acceptable investment for an exempt employees trust. The specialist should check Form 5500 or 5500C to see if there is an indication that payments were made in assets other than cash or its equivalent.

(2) Contributions are generally required to be made in cash. The plan provisions pertaining to employer contributions are controlling as to whether a contribution has to be in cash. If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, if the plan permits the contribution to be made in cash or in kind no prohibited transaction would occur. (Note special rules under 4975(f)(3) of the code for encumbered property.) Example: Corporation XYZ maintains a qualified profit sharing plan. The plan permits contributions to be made in cash or in kind contributions.

On April 5, 1988 Corporation XYZ contributes 100 shares of ABC stock to the profit sharing plan. ABC stock is traded on the New York Stock Exchange and on April 5, 1988 it traded at 10.00 a share unchanged. This would not constitute a prohibited transaction for purposes of 4975 of the code.

(3) Finally, anytime an employer contributes over-valued property and takes a deduction for the claimed value IRC 404 would also be implicated.

APPENDIX B

Chapter 300
Detailed Techniques – Defined Benefit Plans

324 (2-13-81) 7(10)54
Contributions in the Form of Other Property

324.1 (8-24-89) 7(10)54
General

(1) When an employer makes a contribution in the form of property other than cash, all elements of the transaction should be carefully scrutinized by the specialist. There are numerous violations, including prohibited transactions, in this area. These violations occur not only with regard to the fair market value (FMV) of the property claimed as a deduction, but also as to whether the transferred asset is an acceptable investment for an exempt employees trust. The specialist should check Form 5500 or 5500C to see if there is an indication that payments were made in assets other than cash or its equivalent.

(2) Contributions should generally be made in cash. The plan provisions relating to employer contributions are pertinent as to whether a contribution has to be in cash. If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, even if the plan permits the contribution to be made in cash or in kind a prohibited transaction may still occur. (Note special rules under 4975(f)(3) of the code for encumbered property.) See (10)54 of LEM VII.

(3) Finally, anytime an employer contributes overvalued property and takes a deduction for the claimed value IRC 404 would also be implicated.

APPENDIX C

Chapter 700
Qualified Trusts – Activities

723 (7-15-88) 7(10)54
Identifying the Prohibited Transaction

(1) The specialist should inspect the plan records to ascertain if any of the following transactions have taken place directly or indirectly between the plan and a disqualified person:

(a) Sale, exchange, or lease of any property, (See 723:(2));

(b) Loans or extensions of credit, (See 723:(3));

(c) Furnishing goods, services or facilities, (See 723:(4));

(d) Transfer to, or use by or for the benefit of, a disqualified person of any income or assets of the plan, (See 720.3:(5));

(e) Dealings by a fiduciary with the income or assets of the plan for his/her own interest;

(f) Receipt by a fiduciary of any consideration, from a party dealing with the plan in connection with a transaction involving income or assets of the plan, (See 720.3:(6) and (7)); or

(g) Acquisition and holding of employer securities or real property (See 720.3:(8)).

(2) Sale, exchange or leasing of property:

(a) The specialist should inspect the plan records to ascertain whether there have been any sales,

exchanges or leases of property. If such a transaction has occurred the specialist should request back-up documents to determine if the transaction is prohibited. Documents which might be examined to ascertain whether a prohibited transaction has occurred include, but are not limited to: purchase-sales agreements, mortgages, land contracts, liens, deeds, lease and rental agreements and brokerage statements.

(b) The sale, exchange or leasing of property, directly or indirectly, between a disqualified person and the plan constitutes a prohibited transaction whether the transaction was made from disqualified person to the plan or from the plan to the disqualified person.

(c) If a disqualified person transfers real or personal property to a plan, that transfer constitutes a sale or exchange such as to make the transfer a prohibited transaction if:

1 the property is subject to a mortgage or lien which the plan assumes; or

2 if the plan takes the property subject to a mortgage or similar lien which was placed on the property by a disqualified person within 10 years prior to the transfer. [IRC 4975(f)(3)]

Such a transfer of real or personal property will most often arise in the context of a contribution of property other than cash by the employer. It should be noted that the issue of whether a contribution of property, even though unencumbered, by an employer constitutes an exchange within the definition of a prohibited transaction, has not yet been decided by the Service.